

(2) *Special rules for financial products.* [Reserved]

[T.D. 8658, 61 FR 9329, Mar. 8, 1996; 61 FR 15891, Apr. 10, 1996]

§ 1.883-1 Exclusions from gross income of foreign corporations.

(a) *Earnings of foreign ships or aircraft*—(1) *Basic rule.* So much of the income from sources within the United States of a foreign corporation as consists of earnings derived from the operation of a ship or ships documented, or of aircraft registered, under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in that foreign country and to corporations organized in the United States shall not be included in gross income.

(2) *Equivalent exemption*—(i) *Ships.* A foreign country which either imposes no income tax, or, in imposing that tax, exempts from taxation so much of the income of a citizen of the United States nonresident in that foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States is considered as granting an equivalent exemption for purposes of the exclusion from gross income of the earnings of a foreign ship or ships.

(ii) *Aircraft.* A foreign country which either imposes no income tax, or, in imposing that tax, exempts from taxation so much of the income of a citizen of the United States nonresident in that foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of aircraft registered under the laws of the United States is considered as granting an equivalent exemption for purposes of the exclusion from gross income of the earnings of foreign aircraft.

(b) *Income tax conventions.* Generally, income of any kind which is exempt, under the provisions of an income tax convention to which the United States is a party, from any tax imposed by subtitle A (relating to income taxes) is not included in the gross income of a foreign corporation. However, see paragraph (a) of § 1.894-1 for certain exceptions to this rule. Income on any tax

which imposed by such subtitle is limited by an income tax convention is included in the gross income of a foreign corporation if it is not otherwise excluded from gross income. For the determination of the tax when the taxpayer has income upon which the tax is limited by an income tax convention, see § 1.871-12.

(c) *Other exclusions.* Income which is from sources without the United States, as determined under the provisions of sections 861 through 863 and the regulations thereunder, is not included in the gross income of a foreign corporation unless such income is effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation. To determine specific exclusions in the case of other items which are from sources within the United States, see the applicable sections of the Code. For special rules under a tax convention for determining the sources of income and for excluding, from gross income, income from sources without the United States which is effectively connected with the conduct of a trade or business in the United States, see the applicable tax convention. For determining which income from sources without the United States is effectively connected with the conduct of a trade or business within the United States see section 864(c)(4) and § 1.864-5.

(d) *Effective date.* This section applies for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.883-1 (Revised as of January 1, 1971).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 7293, 38 FR 32799, Nov. 28, 1973; 38 FR 34203, Dec. 12, 1973]

§ 1.884-0 Overview of regulation provisions for section 884.

(a) *Introduction.* Section 884 consists of three main parts: a branch profits tax on certain earnings of a foreign corporation's U.S. trade or business; a branch-level interest tax on interest paid, or deemed paid, by a foreign corporation's U.S. trade or business; and an anti-treaty shopping rule. A foreign corporation is subject to section 884 by

virtue of owning an interest in a partnership, trust, or estate that is engaged in a U.S. trade or business or has income treated as effectively connected with the conduct of a trade or business in the United States. An international organization (as defined in section 7701(a)(18)) is not subject to the branch profits tax by reason of section 884(e)(5). A foreign government treated as a corporate resident of its country of residence under section 892(a)(3) shall be treated as a corporation for purposes of section 884. The preceding sentence shall be effective for taxable years ending on or after September 11, 1992, except that, for the first taxable year ending on or after that date, the branch profits tax shall not apply to effectively connected earnings and profits of the foreign government earned prior to that date nor to decreases in the U.S. net equity of a foreign government occurring after the close of the preceding taxable year and before that date. Similarly, § 1.884-4 shall apply, in the case of branch interest, only with respect to amounts of interest accrued and paid by a foreign government on or after that date, or, in the case of excess interest, only with respect to amounts attributable to interest accrued by a foreign government on or after that date and apportioned to ECI, as defined in § 1.884-1(d)(1)(iii). Except as otherwise provided, for purposes of the regulations under section 884, the term "U.S. trade or business" includes all the U.S. trades or businesses of a foreign corporation.

(1) *The branch profits tax.* Section 1.884-1 provides rules for computing the branch profits tax and defines various terms that affect the computation of the tax. In general, section 884(a) imposes a 30-percent branch profits tax on the after-tax earnings of a foreign corporation's U.S. trade or business that are not reinvested in a U.S. trade or business by the close of the taxable year, or are disinvested in a later taxable year. Changes in the value of the equity of the foreign corporation's U.S. trade or business are used as the measure of whether earnings have been reinvested in, or disinvested from, a U.S. trade or business. An increase in the equity during the taxable year is generally treated as a reinvestment of the

earnings for the current taxable year; a decrease in the equity during the taxable year is generally treated as a disinvestment of prior years' earnings that have not previously been subject to the branch profits tax. The amount subject to the branch profits tax for the taxable year is the dividend equivalent amount. Section 1.884-2T contains special rules relating to the effect on the branch profits tax of the termination or incorporation of a U.S. trade or business or the liquidation or reorganization of a foreign corporation or its domestic subsidiary.

(2) *The branch-level interest tax.* Section 1.884-4 provides rules for computing the branch-level interest tax. In general, interest paid by a U.S. trade or business of a foreign corporation ("branch interest", as defined in § 1.884-4(b)) is treated as if it were paid by a domestic corporation and may be subject to tax under section 871(a) or 881, and to withholding under section 1441 or 1442. In addition, if the interest apportioned to ECI exceeds branch interest, the excess is treated as interest paid to the foreign corporation by a wholly-owned domestic corporation and is subject to tax under section 881(a).

(3) *Qualified resident.* Section 1.884-5 provides rules for determining whether a foreign corporation is a qualified resident of a foreign country. In general, a foreign corporation must be a qualified resident of a foreign country with which the United States has an income tax treaty in order to claim an exemption or rate reduction with respect to the branch profits tax, the branch-level interest tax, and the tax on dividends paid by the foreign corporation.

(b) *Outline of major topics in §§ 1.884-1 through 1.884-5.*

§ 1.884-1 Branch profits tax.

- (a) General rule.
- (b) Dividend equivalent amount.
 - (1) Definition.
 - (2) Adjustment for increase in U.S. net equity.
 - (3) Adjustment for decrease in U.S. net equity.
 - (4) Examples.
 - (c) U.S. net equity.
 - (1) Definition.
 - (2) Definition of amount of a U.S. asset.
 - (3) Definition of determination date.

- (d) U.S. assets.
 - (1) Definition of a U.S. asset.
 - (2) Special rules for certain assets.
 - (3) Interest in a partnership.
 - (4) Interest in a trust or estate.
 - (5) Property that is not a U.S. asset.
 - (6) E&P basis of a U.S. asset.
- (e) U.S. liabilities.
 - (1) Liabilities based on § 1.882-5.
 - (2) Insurance reserves.
 - (3) Election to reduce liabilities.
 - (4) Artificial decrease in U.S. liabilities.
 - (5) Examples.
- (f) Effectively connected earnings and profits.
 - (1) In general.
 - (2) Income that does not produce ECEP.
 - (3) Allocation of deductions attributable to income that does not produce ECEP.
 - (4) Examples.
 - (g) Corporations resident in countries with which the United States has an income tax treaty.
 - (1) General rule.
 - (2) Special rules for foreign corporations that are qualified residents on the basis of their ownership.
 - (3) Exemptions for foreign corporations resident in certain countries with income tax treaties in effect on January 1, 1987.
 - (4) Modifications with respect to other income tax treaties.
 - (5) Benefits under treaties other than income tax treaties.
 - (h) Stapled entities.
 - (1) Effective date.
 - (i) General rule.
 - (2) Election to reduce liabilities.
 - (3) Separate election for installment obligations.
 - (4) Special rule for certain U.S. assets and liabilities.
 - (j) Transition rules.
 - (1) General rule.
 - (2) Installment obligations.

§ 1.884-2T Special rules for termination or incorporation of a U.S. trade or business or liquidation or reorganization of a foreign corporation or its domestic subsidiary (temporary).

- (a) Complete termination of a U.S. trade or business.
 - (1) General rule.
 - (2) Operating rules.
 - (3) Complete termination in the case of a section 338 election.
 - (4) Complete termination in the case of a foreign corporation with income under section 864(c)(6) or 864(c)(7).
 - (5) Special rule if a foreign corporation terminates an interest in a trust. [Reserved]
 - (6) Coordination with second-level withholding tax.
 - (b) Election to remain engaged in a U.S. trade or business.
 - (1) General rule.

- (2) Marketable security.
- (3) Identification requirements.
- (4) Treatment of income from deemed U.S. assets.
- (5) Method of election.
- (6) Effective date.
- (c) Liquidation, reorganization, etc., of a foreign corporation.
 - (1) Inapplicability of paragraph (a)(1) to section 381 (a) transactions.
 - (2) Transferor's dividend equivalent amount for the taxable year in which a section 381 (a) transaction occurs.
 - (3) Transferor's dividend equivalent amount for any taxable year succeeding the taxable year in which the section 381 (a) transaction occurs.
 - (4) Earnings and profits of the transferor carried over to the transferee pursuant to the section 381 (a) transaction.
 - (5) Determination of U.S. net equity of a transferee that is a foreign corporation.
 - (6) Special rules in the case of the disposition of stock or securities in a domestic transferee or in the transferor.
 - (d) Incorporation under section 351.
 - (1) In general.
 - (2) Inapplicability of paragraph (a)(1) of this section to section 351 transactions.
 - (3) Transferor's dividend equivalent amount for the taxable year in which a section 351 transaction occurs.
 - (4) Election to increase earnings and profits.
 - (5) Dispositions of stock or securities of the transferee by the transferor.
 - (6) Example.
 - (e) Certain transactions with respect to a domestic subsidiary.
 - (f) Effective date.

§ 1.884-3T Coordination of branch profits tax with second-tier withholding (temporary).
[Reserved]

§ 1.884-4 Branch-level interest tax.

- (a) General rule.
 - (1) Tax on branch interest.
 - (2) Tax on excess interest.
 - (3) Original issue discount.
 - (4) Examples.
 - (b) Branch interest.
 - (1) Definition of branch interest.
 - (2) [Reserved]
 - (3) Requirements relating to specifically identified liabilities.
 - (4) [Reserved]
 - (5) Increase in branch interest where U.S. assets constitute 80 percent or more of a foreign corporation's assets.
 - (6) Special rule where branch interest exceeds interest apportioned to ECI of a foreign corporation.
 - (7) Effect of election under paragraph (c)(1) of this section to treat interest as if paid in year of accrual.
 - (8) Effect of treaties.

§ 1.884-1

26 CFR Ch. I (4-1-03 Edition)

- (c) Rules relating to excess interest.
 - (1) Election to compute excess interest by treating branch interest that is paid and accrued in different years as if paid in year of accrual.
 - (2) Interest paid by a partnership.
 - (3) Effect of treaties.
 - (4) Examples.
- (d) Stapled entities.
- (e) Effective dates.
 - (1) General rule.
 - (2) Special rule.
 - (f) Transition rules.
 - (1) Election under paragraph (c)(1) of this section.
 - (2) Waiver of notification requirement for non-banks under Notice 89-80.
 - (3) Waiver of legending requirement for certain debt issued prior to January 3, 1989.

§ 1.884-5 Qualified resident.

- (a) Definition of qualified resident.
- (b) Stock ownership requirement.
 - (1) General rule.
 - (2) Rules for determining constructive ownership.
 - (3) Required documentation.
 - (4) Ownership statements from qualifying shareholders.
 - (5) Certificate of residency.
 - (6) Intermediary ownership statement.
 - (7) Intermediary verification statement.
 - (8) Special rules for pension funds.
 - (9) Availability of documents for inspection.
 - (10) Examples.
- (c) Base erosion.
- (d) Publicly-traded corporations.
 - (1) General rule.
 - (2) Established securities market.
 - (3) Primary traded.
 - (4) Regularly traded.
 - (5) Burden of proof for publicly-traded corporations.
- (e) Active trade or business.
 - (1) General rule.
 - (2) Active conduct of a trade or business.
 - (3) Substantial presence test.
 - (4) Integral part of an active trade or business in the foreign corporation's country of residence.
- (f) Qualified resident ruling.
 - (1) Basis for ruling.
 - (2) Factors.
 - (3) Procedural requirements.
 - (g) Effective dates.
 - (h) Transition rule.

[T.D. 8432, 57 FR 41649, Sept. 11, 1992; 57 FR 49117, Oct. 29, 1992; 57 FR 60126, Dec. 18, 1992, as amended by T.D. 8657, 61 FR 9338, Mar. 8, 1996]

§ 1.884-1 Branch profits tax.

- (a) *General rule.* A foreign corporation shall be liable for a branch profits tax

in an amount equal to 30 percent of the foreign corporation's dividend equivalent amount for the taxable year. The branch profits tax shall be in addition to the tax imposed by section 882 and shall be reported on a foreign corporation's income tax return for the taxable year. The tax shall be due and payable as provided in section 6151 and such other provisions of Subtitle F of the Internal Revenue Code as apply to the income tax liability of corporations. However, no estimated tax payments shall be due with respect to a foreign corporation's liability for the branch profits tax. See paragraph (g) of this section for the application of the branch profits tax to corporations that are residents of countries with which the United States has an income tax treaty, and § 1.884-2T for the effect on the branch profits tax of the termination or incorporation of a U.S. trade or business, or the liquidation or reorganization of a foreign corporation or its domestic subsidiary.

(b) *Dividend equivalent amount*—(1) *Definition.* The term “dividend equivalent amount” means a foreign corporation's effectively connected earnings and profits (“ECEP”, as defined in paragraph (f)(1) of this section) for the taxable year, adjusted pursuant to paragraph (b) (2) or (3) of this section, as applicable. The dividend equivalent amount cannot be less than zero.

(2) *Adjustment for increase in U.S. net equity.* If a foreign corporation's U.S. net equity (as defined in paragraph (c) of this section) as of the close of the taxable year exceeds the foreign corporation's U.S. net equity as of the close of the preceding taxable year, then, for purposes of computing the foreign corporation's dividend equivalent amount for the taxable year, the foreign corporation's ECEP for the taxable year shall be reduced (but not below zero) by the amount of such excess.

(3) *Adjustment for decrease in U.S. net equity*—(i) *In general.* Except as provided in paragraph (b)(3)(ii) of this section, if a foreign corporation's U.S. net equity as of the close of the taxable year is less than the foreign corporation's U.S. net equity as of the close of the preceding taxable year, then, for